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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
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YANN GERON,

Plaintiff,

v. 12 CV 1364(WHP)
11 CV 8967(WHP)

ROBINSON & COLE, LLP, et al.,

Defendants.

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New York, N.Y.
July 31, 2012
1:15 p.m.

Before:

HON. WILLIAM H. PAULEY, III,

District Judge

APPEARANCES

DiCONZA TRAUIG MAGALIFF, LLP
Attorneys for Plaintiff
BY: HOWARD P. MAGALIFF

MEISTER SEELIG & FEIN,LLP
Attorneys for Defendant, Robinson & Cole, LLP
BY: CHRISTOPHER J. MAJOR

SEYFARTH SHAW, LLP
Attorneys for Defendant, Seyfarth Shaw, LLP
BY: ROBERT W. DREMLUK

THOMPSON HINE, LLP
Attorney for Defendant, Seyfarth Shaw, LLP
BY: THOMAS FEHER

(Case called; in open court)

THE LAW CLERK: Appearances for the plaintiff.

MR. MAGALIFF: Good afternoon, your Honor. Howard Magaliff of DiConza Traurig Magaliff for Mr. Geron who is seated with me at the table.

THE COURT: Good afternoon, Mr. Magaliff.

THE LAW CLERK: For the defendants.

MR. MAJOR: Good afternoon, your Honor. Christopher Major of Meister Seelig & Fein representing Robinson & Cole.

THE COURT: Good afternoon, Mr. Major.

MR. FEHER: Good afternoon, your Honor. Thomas Feher representing Seyfarth Shaw, LLP, and I am accompanied by Robert Dremluk of Seyfarth Shaw.

THE COURT: Good afternoon, gentlemen.

This is argument on the defendant's motions to dismiss and for summary judgment.

Mr. Major, do you want to be heard?

MR. MAJOR: Yes, please, your Honor.

Your Honor, this case presents an exceedingly simple set of facts: The Thelen firm imploded in 2008. In the fall of 2008, the Thelen partners voted to dissolve the firm. And as part of that vote, they also voted to execute what is called by the trustee, a "*Jewel* waiver." *Jewel* is a case from the mid 1980s in an intermediate appellate court in California which essentially held that partners have the duty to account to one

another for unfinished business conducted while the partnership is being wound down.

Robinson & Cole subsequent to the dissolution hired nine former Thelen partners and it's alleged by the trustee that those Thelen partners, along with other attorneys at Robinson & Cole who did not start at Thelen, worked on unfinished matters that had been originated at the Thelen firm. There is no allegation anywhere in the complaint that Robinson & Cole took over matters that were on contingency while at Thelen. There is an allegation in the brief by the trustee that he didn't plead one way or another, but I would respectfully submit to the Court that he can't rely on his own vagueness in his pleading to try get past the motion to dismiss. So having failed to plead any quantum meruit claim, what we're talking about here are hourly fee cases, and I think those are the only inferences that the Court can draw from the pleadings.

So with that relatively straightforward set of facts in mind, I think there are three bases on which this Court should dismiss the claim against Robinson & Cole. Just as a footnote, your Honor, I represent only Robinson & Cole, not any of the partners who are also named as partner does in the lawsuit. That very much does matter under California law.

The first reason, and these three reasons are independent, your Honor, is that the pleading is deficient on

its face. The second reason is that under the original Uniform Partnership Act in California, under which *Jewel* is decided, the trustee still cannot recover from a completely separate firm like Robinson & Cole. The only thing *Jewel* stood for is that partners have a duty to account to one another.

THE COURT: Has the trustee settled with the partners?

MR. MAJOR: My understanding is that the trustee has settled with some of the partners. I am not, your Honor, completely up to speed on where those matters stand.

The third reason is under the current statute in California, which is the revised Uniform Partnership Act which makes a critical change that I will get into in a moment from the no-compensation rule that existed at the time of *Jewel* to the reasonable compensation rule, *RUPA* in effect overrules the *Jewel* decision. And we have cited in our briefs some commentary to the effect it was actually intended to overrule cases like *Jewel*.

So I think those are three separate reasons on which the Court should dismiss the complaint by the trustee, and it should be dismissed with prejudice because any amendment would be futile.

I will touch very briefly at the end on Judge McMahon's decision in the *Coudert* case. Seyfarth will be arguing next. They will make all the arguments under New York law. So with that said, let me get into the pleading issues.

First of all, all six counts in the complaint are fraudulent transfer claims and what the trustee alleges was transferred was the duty to account. So the *Jewel* waiver is the transfer that the trustee is alleging in the complaint. By analogy, your Honor, if a party were to execute, let's say, a general release and it turns out later that the party that executed the general release was not authorized to execute it and the release is deemed void, what happens is the parties go back to where they were before the release was signed. The elimination of a release doesn't create claims, but if you read the complaint that is exactly what they said. And I have got further proof of that, your Honor.

The trustee in papers filed with this Court conceded that but for the bankruptcy filing and even if the event of a partnership dissolution, he cannot collect against any of the firms. He has made that concession. So what he is saying is he doesn't have state law claims against any of the firms. I would submit to the Court, your Honor, that he is half right. He is correct that he doesn't have state law claims, and the reason is there is not a single case that has been cited anywhere in any of these briefs, whether in California or New York frankly, where a separate law firm has been held liable under any theory whether it be a duty to account, whether it be that they acquired unfinished business improperly or anything like that except for bankruptcy cases -- Judge Montali's

decisions and more recently Judge McMahon's decision under New York law. So he is half right that he doesn't have state law claims and I don't think there would be much dispute about that.

Where he is wrong is there is nothing in the Bankruptcy Code that somehow transforms a duty to account into a property right. The Bankruptcy Code is set up not to create property rights. In fact, the Bankruptcy Code defers to the state law to determine property rights. What the Bankruptcy Code does, it is a mechanism for collecting and redistributing assets. It sort of provides the mechanics, not the underlying property interests.

THE COURT: On that point, though, assuming that the *Jewel* waiver was a fraudulent transfer, why isn't Robinson & Cole liable as a mediate transferee?

MR. MAJOR: Because nothing was transferred to Robinson & Cole, your Honor. First of all, the trustee would have to allege how the *Jewel* waiver was a transfer to Robinson & Cole. It is impossible to do that since Robinson & Cole stood in the exact same position before the *Jewel* waiver, during the *Jewel* waiver and after the *Jewel* waiver. It was a nonevent for Robinson & Cole. It was arguably an event maybe for the individual Thelen partners by virtue of the *Jewel* waiver which, by the way, every court that I have seen has found to be a valid waiver under California state law. But

even assuming the trustee were to unwind it, it was arguably those partners whose position changed as a result of *Jewel* waiver. In other words, they had a duty to account and then they didn't.

THE COURT: The future profits were transferred to them, weren't they?

MR. MAJOR: The only thing that was transferred in our view, your Honor, at the time the *Jewel* waiver was the duty to account and I think Court may be touching on a key distinction. There is a big difference between what the partners received and what their new law firms received. Even under the Uniform Partnership Act for these partners, their duty to account is for compensation they receives, not that some new entity they become members of receive. It is what they personally receive. Nothing in the Uniform Partnership Act, whether the original or the revised, and nothing in any of the California cases surrounding *Jewel*, provides that the Partnership Act somehow creates property interests for third-parties. In fact, the Partnership Act doesn't apply to third-parties. It governs the relations between partners.

I just want to flag something. The trustee, and this touches on your point, your Honor, about the mediate and immediate transferees, they have alleged in their brief -- they say, Well, we've asserted that you are a transferee, therefore the Court has to accept these allegations as true. That is

incorrect. The Court only has to accept factual allegations as true, not pure legal conclusions, which is what those are. That is at page 20 of trustee's brief.

So, your Honor, for those reasons the complaint doesn't state a plausible cause of action.

THE COURT: What additional facts would the trustee need to plead to adequately allege that Robinson & Cole was a transferee?

MR. MAJOR: He can't do it, your Honor. There is absolutely no duty owed by Robinson & Cole to account to some other law firm. There is no allegation that, for example, Robinson & Cole aided and abetted a breach of fiduciary duty. He couldn't allege that. What Robinson & Cole did essentially was extend a life raft to nine partners who had been cast aside because their firm dissolved and imploded. This is not a situation where you have one enterprise raiding another enterprise. That is not at all what happened. There is not a set of facts out there by which Robinson & Cole could be held liable. For that reason, your Honor, any amendment where the trustee asks for permission to amend would be futile.

Now, the second prong of my argument is that under the Uniform Partnership Act, pursuant to which *Jewel* was decided, the trustee can't prevail. First of all, *Jewel* was decided under what we call the no-compensation rule, which means if a partner finishes business on the date a partnership is in

dissolution that partner is only entitled to whatever his or her partnership share would have been under the dissolving partnership's agreement. That rule has since been changed to reasonable compensation, at least in California. What it is grounded in is the fact that the partner is not entitled to anything more than what you should get under the partnership agreement because you are already duty-bound to wind up the affairs of the business. It is a very straightforward, legal principle that has been engrained in our jurisprudence for years but has been twisted in very recent years in a few limited bankruptcy contexts and I would submit without proper reasoning.

THE COURT: If unfinished business constitutes assets of a debtor, isn't Robinson & Cole the transferee of those assets?

MR. MAJOR: First of all, I don't think, your Honor, that the unfinished business is the property of the estate. The clients have the ultimate right at any time to dismiss their law firms and hire a new law firm. That is an absolute right both for public policy reasons and as a matter of contract. So I don't think that Robinson & Cole was the transferee of the unfinished business. Not from the estate. It wasn't the estate's to transfer. It was the clients that transferred.

For example, your Honor, I can give you a few examples

to illustrate the point. The trustee has not gone out and sued law firms that landed X Associates who brought with them unfinished business. The trustee has not tracked down former matters from Thelen that landed at a law firm that didn't get Thelen equity partners. The trustee hasn't gone after matters that were conducted by law firms where there was a Thelen partner who didn't even work on the matter, because this is all based on the duty to account under the Uniform Partnership Act whereby a partner who conducts the unfinished business of a dissolving partnership is duty-bound to account to his partners. That is why, your Honor, in all of the cases in California the only defendants who have been held liable for the duty to account are partners.

In *Jewel* it was four partners broken into two, two-partner law firms. In the *Resnick* case the new firm was a solo. In the *Ozman* case it was two lawyers split into two firms of one. In the *Little* case it was a two-person partnership which dissolved when one of those two partners died. The *Grossman*, *Fox* and *Rothman* cases -- all the same. There is not a single case other than the bankruptcy cases that hold that the new law firm that had nothing to do with the prior law firm is on the hook for the duty to account, nor could there be because the partnership law which gives rise to that duty to account governs the relationship between the partners, not outside parties.

Now, just to touch on the bankruptcy decisions, Judge Montali respectfully was wrong in his two decisions. In the *Brobeck* decision he essentially -- and he did this in two paragraphs of what was an otherwise very long decision -- after finding the *Jewel* waiver was valid under California law, and that is probably relevant to the partners, again a real nonevent for my client Robinson & Cole -- held the firms were either immediate or mediate transferees and for reasons that your Honor and I discussed a few minutes ago that can't be because you have to have the property right first for something to be transferred, whether immediately or mediately. His second decison, your Honor, in *Heller* just cites to the *Brobeck* footnote, which I just discussed.

So there really hasn't been a court in the face of these claims brought by trustees to really take on this analysis. I think when you go through the California cases, which are laid out in our brief and which I just discussed, and you look at the Uniform Partnership Act and you look at *RUPA*, there is absolutely nothing in there that can create a property right. It is all about the duty that the partners owe to one another. So really the question under *Jewel* and the original Uniform Partnership Act is whether the former partner received more than his or her partnership share under the former partnership agreement for any unfinished business he or she may have may have concluded. Again, it is all about what the

partner received, not the new entity he attaches himself to.

In this case, your Honor, just to put some context in it, these nine Thelen partners were not sharing profits among the nine of them. They were sharing profits among a partnership of approximately 90 equity partners. There is no way that those other 90 equity partners are somehow bound either by the Thelen partnership agreement or by California's now revised Uniform Partnership Act.

Getting to that point, your Honor, this is the third independent basis for the Court to dismiss the complaint with prejudice: The reasonable compensation rule now prevails in California and this is very important. Now the question becomes whether the former partner received unreasonable compensation for performing the unfinished business. We do have an example under California, which ironically long predates the Uniform Partnership Act. It is *Wikholm*, 29 Cal.2d 24. It was decided in 1946. However, even under the original Uniform Partnership Act, there was an exception. In the event of the death of a partner and the surviving partner performed the unfinished work, that surviving partner was permitted reasonable compensation. When you read the *Wikholm* case that partner, the surviving partner there, concluded or attempted to conclude the construction of a military base project and it was found that he was entitled to profits because he was the one who expended the capital and the risk. So under *RUPA*, *Jewel*

goes by the wayside and there has not been a non-contingency case decided in California which upholds *Jewel* after RUPA has been enacted.

Judge Montali even acknowledged that RUPA put *Jewel* in doubt. In his decision in *Brobeck* he admitted that it possibly changed the landscape, but the way he got around it was he cited to this case named *Kuist* and said that it cited the *Rothman* case and postdated *Rupa* so therefore there is some indicia that it survived. However, the *Kuist* case was a contingency fee case. As I said, there has been no case decided under RUPA which extends *Jewel* under California law.

Now, as we just discussed with respect to the Uniform Partnership Act, it frankly doesn't matter because you can't get to Robinson & Cole under either act. Briefly, your Honor, on the Coudert case, it was decided under New York law and therefore it is distinguishable on that basis and that is not a purely academic point. New York follows the no-compensation rule. So Judge McMahon never reached the third prong of my argument.

Now, as I would say even under New York law, the Uniform Partnership Act doesn't get to the non-partner firms. What Judge McMahon held essentially was that there was vicarious liability for partners who joined new firms, that somehow the partners are committing a wrong while at these new firms and their fellow partners are vicariously liable for

their wrongs. There are a couple of problems with that. One, the partners would have to commit wrongful conduct. That didn't happen here. Remember, Judge Montali has ruled twice that the *Jewel* waiver itself is valid under California law. So the partners were within their rights to execute that *Jewel* waiver.

Moreover, the trustee doesn't claim in this case, or any other case that I have seen, that the partners should turn away the work from these existing clients or that the new firms were wrong just for taking the matters on. It is only the duty to account that is the wrongful conduct, alleged wrongful conduct. I submit that since the *Jewel* waiver was valid, it wasn't wrongful at the time it was allegedly committed, and therefore you don't have the wrongful act. Even if you concede the wrongful act, which we don't, it wasn't within the ordinary course of Robinson & Cole's business. Robinson & Cole is in the business of performing legal services for clients and charging them fees for those services. That one of their partners may have under law or under contract a duty to a wholly separate entity is well outside the realm of Robinson & Cole's business.

So, your Honor, just in closing again Robinson & Cole hired these partners post-dissolution. There is no allegation that Robinson & Cole engaged in any wrongful conduct. In fact, what Robinson & Cole did was actually a good thing. They gave

these partners a life raft and the upshot of what the trustee is seeking to do is turn these partners who are looking for places to land into less attractive candidates by engaging in essentially a fiction of turning partner duties to one another somehow into a property interest. There is no statute and there is no case to support that, your Honor.

So unless the Court has any questions, I can conclude.

THE COURT: Thank you, Mr. Major.

Mr. Feher.

MR. FEHER: Thank you, your Honor. I appreciate the opportunity to be in front of you again and thank you for accommodating our schedule today.

THE COURT: I appreciate your accommodating mine, because I have a jury that is deliberating and you can't always manage those things, which is why I had to move the schedule from this morning.

MR. FEHER: Well, my fiancee has asked me to express her gratitude for your not giving me an excuse for us to be late for our wedding trip.

Your Honor, the fundamental question to be addressed under New York law is what circumstances, if any, can require a law firm to disgorge -- to its clients' former lawyers -- fees that it earns for work done by its own lawyers at an undisputedly reasonable rate. The answer under New York law is none. The trustee's analysis of California law, as described

by Mr. Major, is inaccurate anyway, but under New York law it is even more difficult. Under New York law that claim would not even survive against the partners who had been at Thelen, let alone a third party like Seyfarth. There must, as Mr. Major said, be a reasonable expectation of a property interest for any of the trustees' claims can survive, and that interest doesn't exist under New York law. The fact is Thelen had no right to these clients. It had no right to control where they went or who they hired. It had no right to any portion of future fees that those clients paid to other law firms.

THE COURT: As a general rule, isn't it true that unfinished business on the date a partnership dissolves is an asset of the partnership?

MR. FEHER: Using the euphemism "unfinished business" from general partnership law in this context ignores the reality of the situation. We're talking about the application of some general statutes from a long time ago that are meant to apply to almost any partnership. New York courts have gone beyond that. We're not talking here about a situation where there was a contract to supply a specified number of pipes or a contract to build to completion an Army base or a railroad station. What we're talking about here is an agreement to provide legal services on an hourly basis that is terminable at will by either party. Thelen had no more right to demand that clients continue to hire them and pay them after dissolution

than it had before dissolution.

THE COURT: Haven't New York State courts held that even a contract that is terminable at will by a client is a partnership asset?

MR. FEHER: If there is a contingent agreement, yes. But certainly the cases that are out there in New York dealing with these issues have gone the other way on hourly matters.

THE COURT: What about *Stem*?

MR. FEHER: First of all, *Stem* is not a legal case. It has none of those overlays. Judge McMahon says she sees no reason to treat architects differently than lawyers. In fact, there are many reasons to treat them differently. In fact, the New York Court of Appeals in the *Cohen* case said, What partners agree to is one thing, but our ethical rules supplant that. New York courts have said, Whether it is in *Cohen*, whether it is in *Sheresky*, whether it is *Burke*, notwithstanding the written or unwritten provisions of partnership agreements, these rules that are specific in the policy rules come first.

In this situation, the ethics rules are very clear. You cannot split the fees. We recited these rules in our briefs. You cannot pay fees to nonlawyers. You cannot pay fees to other lawyers, except in proportion to the work they do. There is no proportion here, your Honor. Thelen dissolved. They could not do any of the work, let alone enough of the work to take all of the profits, which is what they

claim here. It is a violation of the ethical rules, it is a violation of the rules on splitting fees with nonlawyers and it is a violation of the rule that requires the client to consent to a split of fees.

THE COURT: Do ethical rules trump a statute?

MR. FEHER: They do, your Honor. They certainly did in the context of *Cohen*. The rules of the Court of Appeals govern how lawyers in this state practice. They promulgate those rules and they decide the case law. In this situation, by the way, there is nothing in the legislative history or in the statute so particular as to suggest that it was intended to specifically apply to lawyers or the repayment of future hourly fees. More importantly, the statute doesn't have anything to do with Seyfarth. Seyfarth was not a party to that partnership agreement. As Mr. Major has said the claim, if there is a claim and if it does trump the ethical rules and policy considerations, is as against those former partners.

THE COURT: Have the former Thelen partners who are now Seyfarth partners, have they all resolved the claims by the trustee against them?

MR. FEHER: It is my understanding, your Honor, that they have. I haven't delved deeply into that, but that is my understanding. I understand also that the terms of those agreements are confidential. That is as much as I know about it.

THE COURT: All right.

MR. FEHER: I would suggest, however, that whatever agreement the trustee reached that was his decision. If he gave up claims against those partners, he must have made his own decisions that the compensation he got was adequate. If he did not give up the claims against those partners, then he is free to bring them in or sue them independently. The issue, as Mr. Major said, of what they got and what their duty to account to what their former partnership is is different than what Seyfarth got. In most of these situations it would not surprise the court to find out that the former Thelen partners are not the only people working on those cases.

It's interesting that Thelen's position is that they are in a better situation once they dissolved. They can no longer provide the legal service to this client. The client not even of its own choosing but because of this dissolution has to go out and hire a new law firm. And that new law firm, according to Thelen, is obligated to pay back its profit for taking on those clients. As we know from this very case, prior to dissolution any partner could leave Thelen, go work at Seyfarth, Robinson & Cole or any other law firm and do so without any fear of having to pay anything back to Thelen. We know that is true in this case because Thompson Hine was dismissed when it was discovered that its partners had left before the dissolution. That is the law in New York. That is

what *Cohen* says. That is what the law is.

Thelen's position is that somehow by virtue of its own failure to survive, by virtue of the fact that it left clients and lawyers high and dry, it is better off than it was before it was dissolved and before it filed bankruptcy. It is so counterintuitive it is hard to argue against. The fact that there is a set of cases in California dealing with disputes over contingent matters between former partners who are essentially raiding each other's pockets doesn't mean anything in the context of these cases. Those cases are different facts. They are decided under different law and they don't have any application here.

It is significant, when we talk about a property interest, to think about the distinction between contingent cases and hourly cases. In an hourly case if a Thelen partner works for an hour, Thelen had a right to be paid for that hour. If a Seyfarth partner worked for an hour, Seyfarth is entitled to be paid for it. But those hours belong to those firms and the dissolution of Thelen doesn't change that. We're not talking about accounts receivable. If the allegation in this case was that Thelen had done work that was unpaid and that that unpaid receivable had been transferred to and collected by Seyfarth, we would be talking about a transfer.

Instead what the trustee alleges is a right to a future portion of the Seyfarth's fees was a property interest,

and that doesn't make any sense. Contrast that with the contingent fees where, if Thelen had such cases, they would have done work, and they would have not been paid for it. It amounts to a receivable, but that is not what the allegation is here. That is the problem with the pleading, your Honor. There is not an allegation that there is anything that Thelen did that it was unpaid for. This isn't a Jackson Pollack. This isn't a piece of furniture.

THE COURT: What about Judge McMahon's reliance on the need for Uniform Partnership Act jurisdictions to harmonize their interpretations?

MR. FEHER: Well, your Honor, I would submit that her decision doesn't achieve that. Mr. Major has properly pointed out that the decisions in California have to do with a particular set of facts that have no application here. The decisions in California have to do with essentially fights between partners over fiduciary duties that they owed to each other when their firms split up. The defendants in those cases are either the individual partners or the firm's they have formed. As Mr. Major said no third party firms have been held liable under this line of cases.

So there is nothing un-uniform, if you will, about ruling in this situation that as to hourly fees there is no property interest and therefore there cannot be a fraudulent transfer claim. In fact, to the contrary, the cases that are

out there that deal with hourly fees have found that there is no such right. Including, in fact, the *Sheresky* case here and the *Burke* case here. So the issue of uniformity is one that actually favors dismissing this complaint as opposed to denying that motion to dismiss.

THE COURT: I think I understand your arguments, Mr. Feher.

MR. FEHER: Thank you, your Honor.

THE COURT: Mr. Magaliff, do you wish to be heard on behalf of the trustee?

MR. MAGALIFF: I do, your Honor. Thank you.

THE COURT: First, starting with very first point that Mr. Major made in his argument, do you have reason to believe that any of the matters at issue are contingency fee matters as opposed to hourly fee matters?

MR. MAGALIFF: My understanding is that nearly all of them were hourly fee matters but not all of them.

THE COURT: Am I correct to understand that the trustee has settled with the former Thelen parters who moved to Seyfarth?

MR. MAGALIFF: Your Honor, the trustee settled with many partners, but significantly the trustee did not settle unfinished business or *Jewel* claims. Those were specifically carved out of every single settlement that the trustee entered into.

THE COURT: Is that also true with respect to Thelen & Cole partners who moved to Robinson & Cole?

MR. MAGALIFF: All partners whom the trustee settled with regardless of where they went to carved out unfinished business claims.

THE COURT: Okay.

MR. MAGALIFF: I think the place to start, your Honor, is to understand what the case is. There are two things really that set this case apart from virtually every other case that has been discussed or cited in the briefs. The first is that this is a partnership in dissolution and operates by a different set of rules. All the cases that discuss this recognize that there are a different set of rules for partnership and dissolution as opposed to a situation where a partner leaves or where one partner dies.

The second is that this a bankruptcy case. There is an overlay of bankruptcy law that cannot be ignored, that distinguishes what is going on here from most of the other cases that have been cited in the briefs. The overriding principle in bankruptcy law, your Honor, is to marshal and collect and reduce to money, assets of the estate, for distribution to creditors. It is important in the sense that Robinson & Cole for instance has argued that under the Revised Uniform Partnership Act, limited partners in a registered limited liability company are not liable for the debts of the

partnership. Well, that is what RUPA said, that is what Thelen's partnership agreement says.

But recognizing there is a difference, Thelen's partnership agreement also says that we are waiving unfinished business claims as among the partners and the partnership because there is a difference. Because when you recover an asset of the estate, you are not going out to all the former partners and saying Thelen had liabilities $150 million. You are all going to contribute according to your percentage equity ownership to make up that difference. That is what happens in a general partnership. This wasn't a general partnership. The purpose of recovering assets in a bankruptcy case, your Honor, is to bring them all in, as many as you can, and then to distribute them pro rata to the creditors in the statutory order of priority. It is very different.

THE COURT: Isn't *Jewel* limited to general partnerships?

MR. MAGALIFF: *Jewel* was a general partnership case, your Honor, but there have been subsequent cases which have discussed the concept of unfinished business in the situation of registered limited liability partnerships or other types of partnerships. In fact, there is a case -- I don't recall which one it is, but it is cited in one of the papers -- where the judge specifically talks about the fact that you have to look beyond the form of a professional corporation or an entity

where the partnership is made up of other entities because at bottom you have lawyers who are practicing law with an expectation that the firm as a whole is going to recover revenues.

Remember, what we're talking about here, Judge, are client matters. We're not talking about clients. We're talking about business that belonged to the partnership. And every case that has looked at this recognizes that the matters in a law firm belong to the partnership. Thelen's partnership agreements specifically says, for example in Section 2.3 I think, that the earnings of the partners from the practice of law belong to the partnership. Of course that makes sense. You take Robinson's argument that they receive nothing when the former partners came to the firm. It makes no sense.

They weren't altruistic by throwing out a life raft and saying, Come work for us. They expected these lawyers to generate revenue, bill clients, collect fees and for everybody to make money. When a partner leaves a dissolved firm, your Honor, there is a different set of rules that applies. That is what the partnership laws say. In both states, New York and California, a partner who leaves a dissolved firm is governed by the obligations imposed on him or her by the partnership law. The firm which takes the partner from the dissolved firm must also equally recognize that this partner may come with baggage in the form of an unfinished business claim.

THE COURT: Under RUPA, why wouldn't profits from unfinished hourly fee matters constitute reasonable compensation?

MR. MAGALIFF: Well, I think what the cases say, your Honor, is that the lawyers are entitled to reasonable compensation but profits don't equal compensation. Even Judge McMahon recognized that you have to determine what is a reasonable amount of money to pay.

I will give you a perfect example. A lawyer goes to a firm and bills at $800 an hour. The lawyer isn't paid $800 an hour. Out of the 800 bucks an hour that the new firm collects, they have to pay all of their expenses, they have to pay salaries, they have to pay overhead, and they have to pay reasonable compensation to the lawyer under RUPA who performs those services.

Does reasonable compensation to the lawyer mean the entire difference between the cost and the hourly rate? The cases don't say that. The only cases that have spoken to that say you have to have an accounting. You have to determine what is reasonable compensation. Even Judge McMahon when she was talking about the *Kirsch* rule recognized that -- and Judge Montali also -- as a practical matter when you get through with your accounting and your analysis, which by the way is not proper on a motion to dismiss or for judgment on the pleadings, but when you get through with this analysis it may be that you

have very little profit. It may be that you have no profit. But it may be there is a quantum of revenue there that exceeds what the properly allocable expenses are to complete the unfinished business plus reasonable compensation to the attorney.

THE COURT: Isn't there a difference given the fact that *Jewel* as I understand it was based on the no-compensation rule?

MR. MAGALIFF: *Jewel* was based on the no-compensation rule and New York follows the no-compensation rule. One of the points that Judge McMahon made in her analysis, which Mr. Feher touched upon, is the importance of Section 4.4 of New York partnership law. That is a statute that deals with construction. You raised the question, your Honor, how does the New York court or federal court interpreting New York law decide what this means when there is no controlling law from the state's highest court. What the statute says is that you have to interpret New York's law to be consistent with the law in other Uniform Partnership Act jurisdictions, i.e, no-compensation jurisdictions. That is what Judge McMahon did, a thorough analysis and that is why she looked at cases from many of the jurisdictions. One of the defendants said we have a case right here. We have *Sheresky*.

THE COURT: But *RUPA* repealed the no-compensation rule.

MR. MAGALIFF: Yes, it did, but that is a fact issue. It is a fact issue, Judge, as to what constitutes reasonable compensation. There is no case that says per se reasonable compensation is the entire profit margin, if you will, that is earned from whatever hourly fee is charged less the cost and the overhead and expense that comes out of that hourly fee.

THE COURT: Let's skip back to New York then. Given Judge Bransten's decision in *Sheresky*, why shouldn't this Court defer to that state court on a matter of New York state public policy?

MR. MAGALIFF: I will tell you. Because Justice Bransten did not herself do what the statute instructs. She did not look at any other Uniform Partnership Act cases in any jurisdiction in the absence of controlling law by the New York Court of Appeals. She looked at three contingent fee cases, at least one of which was also cited by Judge McMahon, and she said, Well, the only thing that there is in New York is contingent fee cases so I don't think it applies.

Judge McMahon did what the statute requires and what all federal judges do when they are asked to rule on a matter of state law where the court has not set the precedent. She went out and she made a determination as to what she believed the New York Court of Appeals would rule. Is she right? I don't know. She just granted an interlocutory appeal and it is going up to the Second Circuit and maybe the circuit will

certify it to the New York Court of Appeals and maybe it won't.

THE COURT: I wouldn't bet against it.

MR. MAGALIFF: No, I wouldn't bet against it either.

She did point out in her decision granting the interlocutory appeal that she believes that when the New York Court of Appeals does the same analysis that is required by Section 4.4, it will most likely come up with the same conclusion. But you are right, we don't know. The point about *Sheresky* is that Justice Branstein didn't do it. In Mr. Feher's words, or maybe Mr. Major's words, that was just a couple of paragraphs in a much larger decision. There was no analysis at all. Now, we have to assume, your Honor, that Judge McMahon knew about the *Sheresky* decision when she wrote her decision in *Coudert*.

THE COURT: She didn't mention it.

MR. MAGALIFF: No, she didn't mention it. But it is interesting because she points out in her decision that the Second Circuit also didn't talk about the *Cohen* decision and *Denburg* decision in *Santalucia* even though they were out there and they had some ostensible relevance to the issue being decided. So the fact that there is a case out there that you don't mention doesn't necessarily mean that you can draw any inference one way or another.

I don't know, but I do know that Justice Branson did not do the analysis that is required by the statute, that Judge

McMahon did and came up with the conclusion that she came up with. Right now, okay, you don't have to follow that. I understand that, but right now Judge McMahon's decision is the controlling authority here on the question of whether or not the New York Court of Appeals would recognize a claim for unfinished business.

Now, let's talk about the property interests. We've argued, and I think it is clear that whether it is California law or New York law, a dissolving firm on the date of dissolution has an asset in the form of its clients' matters. These are not clients. We know that firms don't own clients and the clients can go anywhere they want. Judge McMahon recognized that when she did an analysis and applied a New York public policy does not bar unfinished business claims and Bankruptcy Judge Stoll, I think it was, in the *Labrum* & *Doak* case in 1998 did a similar analysis under the Pennsylvania model rules of professional conduct, which had very similar provisions, and came to the conclusion it was not improper because what you were doing here was squaring up under partnership law as to what the partners owed to each other.

So we have a property interest in the unfinished business in the matters. That property interest was divested by the execution of the Jewel waiver. Now, what happens if you avoid the waiver? It is not simply a matter of saying nothing because all that comes back is a duty to account because that

evidences a misunderstanding of what the duty to account is all about. It is not just give my a spreadsheet, give me a chart, show me what goes in Partner A's column, Partner B's column or Partner C's column. It entails a squaring up at the end of that Partner C has more than he or she is supposed to have.

THE COURT: I am intrigued by some of the hypotheticals that were posed by some of the moving parties. If unfinished hourly fee matters are property of the estate, can they be sold to the highest bidder?

MR. MAGALIFF: I don't know, your Honor.

THE COURT: There is a trial that just began involving Samsung and Apple. If a firm involved there was in bankruptcy, could they just auction the right to represent Samsung in the patent infringement case of the century if I take the reports from California at face value?

MR. MAGALIFF: No. I don't think so. Nothing in the jurisprudence --

THE COURT: Why not? Why couldn't they if it is the property of the estate?

MR. MAGALIFF: Because the right to represent a client is not a right that belongs to the law firm. It is not the representation that is the property right because of course the client can always discharge the lawyer before bankruptcy, during bankruptcy, after bankruptcy. But so long as the lawyer who is a former partner of the firm that dissolved is

continuing to work on the matters that were unfinished business matters, the cases and the statutes say that the profit, and whether it is all profit because you are in a no-compensation jurisdiction or the profit over and above reasonable compensation, has to go back to the former firm.

If one of these clients came to Robinson & Cole or Seyfarth Shaw and those firms worked on a matter for six months and then the client said, You know what, I don't like what you are doing so I am going to go get another lawyer, the claim for unfinished business as against the firm, the initial firm, would be limited to the profits in the six months during which the firm represented it. That firm would not be liable for what happens at the next firm. We're not talking about what claims the estate might have against subsequent firms. We're talking about the business that is completed and the profit on the revenues generated from completing that business while the former partners are at the firm doing it. That is what this case is about.

So when you avoid the Jewel waiver, your Honor, and the duty to account comes back, what comes back with it is payment if the squaring up says there ought to be payment. These firms, they cannot credibly sit here, Judge, and say we got no benefit. They were getting the revenues. The partners all worked for the firm. The revenues were coming into the firm. The matters were firm matters. The revenues were firm

revenues. How they got divided is a question of contract law under Robinson's partnership or Seyfarth's partnership or Thelen's partnership. It is not the clients that are owned by the firm. It is the matters and the revenues.

THE COURT: What if in the example you have given the Thelen partner takes a matter and he goes to another law firm and he works on the matter with his colleagues at the new law firm for six months, and then he retires. What is that new law firm -- whether it is Robinson & Cole or Seyfarth -- what is their obligation under trustee's theory?

MR. MAGALIFF: I don't know, but I think the correct answer would be that once the partner is no longer there, whatever duties there are to account back would terminate when that person is no longer a partner. So I would argue or answer your question by saying if the partner retires after six months or eight months that would be the cutoff.

In the discussions that we have had with the firms we have settled with, and we have settled over a dozen cases for two million dollars give or take a couple of bucks, one of the discussions has always been where is the cutoff. Do you go out one year? Do you go out two years? Do you go out until the matter is concluded? There is no definitive answer. In the *Heller* case they have been publically settling cases with a two-year cutoff from the time of dissolution.

There are areas here, Judge, that don't have

decisions. Mr. Major talks about, Well, there is no decision. Yes, there may not be any decisions, but that is not to say that there isn't a rather robust and well developed body of case law that goes back 100 years as to how you treat partnership assets and what responsibility former partners have to their law firms. It has been adopted, if you will, and recognized in the jurisprudence that if the model of law firm changes, the underlying duty doesn't change. I think even Judge McMahon made some reference to, you know, the quaint rules in the day of the mega firm, but this is the law.

These are the rules and this is what the New York partnership law requires and even California *RUPA* doesn't say there is no unfinished business. *RUPA* says reasonable compensation and it may well be that when you do the accounting and the analysis, it comes down to very little. Even Judge McMahon said that. She said if it was one way, it would be very easy. No-compensation law, you take revenues, you take off costs, here is your answer. If it is a reasonable compensation jurisdiction, if that is what the New York Court of Appeals decides, well, then it is going to be harder because the accounting will be different. One way or another you have to have an accounting. Those are fact questions.

Again, I get back to one of the things I said from the beginning, Judge, this is a motion to dismiss by Robinson & Cole. It is a motion for judgment on the pleadings by

Seyfarth. It is not a motion for summary judgment. Although, I do recognize that if you were to rule that under California law or New York law or both there is no such thing as an unfinished business claim for hourly matters that might effectively achieve the same result. But since we believe that there is a tremendous amount of jurisprudence that says that you do recognize hourly matters, then we have to test the sufficiency of the trustee's complaint under the rules of Federal Rules of Civil Procedure, *Twombly* and *Iqbal* and the requirements of Rule 8 and requirements of Rule 12(b) and the trustee has more than adequately pled everything that he needs to sustain on a motion to dismiss the claims that are asserted in the complaint. I don't think there is any question about that, Judge.

THE COURT: On the conflict of laws point, if I could just digress for a moment, how could Seyfarth be bound by the choice of law provision in Thelen's partnership agreement if it wasn't a party to the agreement?

MR. MAGALIFF: It probably can't, your Honor. On that point what we had said in the brief is that there are many facts that Seyfarth alleges which become relevant to a determination of whether New York law applies or not if you rule that hourly-fee matters are not part of the unfinished business. If you conclude, as we think you must, that hourly-fee matters are cognizable within the realm of

unfinished business under New York as they are in California law, then it really doesn't matter which state's law applies because for purposes of the motion to dismiss, we have met tests. What becomes a triable issue of fact then is what are the appropriate deductions and what is reasonable compensation or not reasonable compensation, what are the revenues and all of those things that go into the calculation and the accounting.

THE COURT: Anything further, Mr. Magaliff?

MR. MAGALIFF: If I could have one moment to look at my notes, I would appreciate it.

THE COURT: Sure.

(Pause)

MR. MAGALIFF: There is one other point, your Honor. I think this ties back into the bankruptcy nature of these claims. Mr. Major said something about Judge McMahon essentially approaching her decision from a perspective of vicarious liability to wrongdoing. This isn't a case of wrongdoing. What the trustee has alleged, your Honor, is a constructive fraudulent transfer under Section 548(a)(1)(B) of the Bankruptcy Code and a constructive fraudulent transfer does not require any allegation of wrongdoing. That is why it is constructive. It looks back on whether property was transferred, whether the transferor or debtor was insolvent or rendered insolvent on the date of the transfer and whether

there was reasonably equivalent value given. Contrast that with Section 548(a)(1)(A), which is an actual fraudulent transfer which looks to the intent of the transferor to hinder, delay or defraud creditors. In that situation you are looking at wrongdoing, but for our claims wrongdoing is not an issue at all.

THE COURT: Thank you, Mr. Magaliff.

Mr. Major, do you want to be heard briefly?

MR. MAJOR: Yes, your Honor. Thank you.

Your Honor, there is a reason Mr. Magaliff struggles to answers some of your questions, for example, can these client matters be sold, what happens in a case of a retired partner -- it is because he is so far out on a limb, these questions cannot be answered. Your Honor, it is not because this is some novel area of law. Mr. Magaliff himself says this has been happening for 100 years. We've been citing cases of law firms breaking up in California since the 1800s. What has happened here is that it is actually a very straightforward area of the law. Under the partnership agreements, partners owe one another a duty to account.

A few courts have taken a wrong turn and have in the bankruptcy context, without a basis I would submit, have applied that and somehow transferred it into a property interest. What we have to go back to is what the trustee sued us on and that is the *Jewel* decision. The *Jewel* decision, and

Mr. Magaliff said right at the start of his argument that none of the cases are dissolution cases, *Jewel* was a dissolution case. We also cited a legion of others. The *Grossman* case, which is in our papers, but *Jewel* is a dissolution case, and what happened there is only the partners had a duty to account. As Mr. Magaliff said it has been happening for a hundred years and the non-party law firms have not been held liable.

The Second Circuit, your Honor, will benefit. If everything is headed to the Second Circuit, the Second Circuit will benefit from this Court taking a thorough analysis and looking at what the trustee has sued us for an going through the California cases because there is no basis under California state law to hold Robinson & Cole liable.

In terms of the unreasonable compensation your Honor was questioning the trustee about that, it frankly doesn't matter which rule you apply from our perspective because all of the cases and the statute talk about the partner accounting. It doesn't matter what the firm that partner is affiliated with collects. It only matters what the partner gets. To touch on that point, your Honor, and frankly I am a little bit handicapped here because I don't represent the individual partners, and Mr. Magaliff can speak to this better, my understanding though is that those partners with whom he settled he said had carve-out for these claims. I think he also gave them covenants not to sue, which means those

carve-outs are not worth very much if I am correct about that.

Finally, your Honor flagged something I forgot to mention in my remarks to the limited liability partnership issue. The former partners of a limited liability partnership cannot be forced to perform work -- that further eviscerates the trustee's claims here.

Finally Mr. Magaliff said in response to my remark that Robinson & Cole had actually done a good thing, he said, Well, they got the benefit of these lawyers who were supposed to work the billable hours. Of course that is the case. What Mr. Magaliff is hinting to the Court is he wants a ransom from the new law firms taking on these lawyers. There is now duty not to compete under the Uniform Partnership Act and certainly as a matter of public policy one can't bar lawyers from competing. That, at the end of the day, your Honor, is what this case is about and I would respectfully submit that is why the trustee has sued the law firms figuring they're better pockets -- he referenced his settlements -- than the individual partners to go after.

THE COURT: Thank you, Mr. Major.

MR. MAJOR: Thank you, your Honor.

THE COURT: Anything further, Mr. Feher?

MR. FEHER: Yes, your Honor.

If you would indulge me for a minute, I would like to first come to the defense of Justice Bransten. It is as false

and unfair as it could be to say that her decision was either cursory or that it failed to do an analysis. This was a matter that was fully briefed by very component counsel on both sides. Proskauer represented the defendants in that case. The briefs are very lengthy and we can provide them to you if it is relevant. The fact is that Justice Bransten had a full set of briefs on all these issues and concluded that hourly matters could not be the basis of an unfinished business claim in New York given the ethical considerations.

The Second Circuit has instructed that district courts when they are trying to assess what the highest court would say is to give great weight to decisions like *Sheresky* and like *Burke*. Yet Judge McMahon completely ignored those cases. She did not do the analysis of what the highest court would do with those specific considerations.

On the *Iqbal* and *Twombly* issue, I respectfully suggest that Mr. Magaliff is exactly wrong. It was his obligation to plead the facts entitling him to relief, not to plead facts that might entitle him to relief. All the Court has to do is look at the *Burke* decision to see what the pleading requirements are to state a claim under New York law. In *Burke* the complaint was filed and it was dismissed for failing to allege that there were current matters. It was refiled and it was dismissed again, specifically for failing to allege that there were contingent matters at issue. That is his obligation

because hourly matters are not compensable and are not unfinished business under New York law. He has to plead that they are contingent matters.

I want to go back briefly to the Court's question about *Stem*. There are two important facts about that. One is, as was noted in other cases cited, that case had a specific fact in it that doesn't exist here. The contract at issue contemplated that it would survive past the death of a partner. More important, *Stem*, like *Jewel* and the other cases we talked about, was a dispute between those former partners and not as to a third-party who took over. It is at end of the day a fiduciary duty claim.

That is not who the parties are here. No one sued another company that came in and did this work just because there was another architect who worked there that was at the former firm. That wasn't the case. It was again a dispute, as was *Jewel*, as every case that talks about unfinished business claims, between those partners. Again, Mr. Magaliff and his client have apparently reached resolution with those partners. They elected their remedies. There is no third-party liability to this firm or to Robinson & Cole for their profits.

Again, we have to go back to the big picture. What the trustee is saying is that firms like Robinson & Cole and Seyfarth are obligated to work for free for these clients just because Thelen couldn't stay in business. The policy

considerations for that are monumental. Mr. Major hinted to this, if that is the rule in New York or California or elsewhere, every partner who senses that his firm might be in trouble has the incentive to leave as soon as possible. The more business he has, the sooner he will leave. It hastens the downfall of law firms.

More importantly, and this is where Judge McMahon I think got it very wrong, this notion that a client doesn't care what happens to the money, that this is just a squaring up after the fact, it is just wrong. It ignores reality. If I were a client, if you were a client, if Mr. Magaliff was a client, he would want to know whether his lawyer was working for free on his case and might have an incentive to work on somebody else's case where they will make more money.

He would also be very interested in the fact that his lawyer could not go to work at a smaller firm who couldn't afford to pay over the profits, who couldn't afford to defend suits like this. He would be interested to know that his lawyer had to go to a mega firm as Judge McMahon likes to talk about it and pay huge hourly rates because his lawyer couldn't go to a smaller firm with lower rates because that firm wouldn't take him because they couldn't afford to defend these suits.

That is a significant policy consideration, and as the courts of New York have found, and in the *Nixon Peabody* case

that we cited to you, talks about the preeminent concern is "Is client choice of lawyer going to be affected by the rule?" This rule would substantially affect the client choice. That is why notwithstanding general partnership law and notwithstanding *Stem* that has to do with architects, New York courts would reach a different result.

Mr. Magaliff acknowledges as he must law firms cannot own their clients. They likewise cannot own the future fees of those clients. That is the client's decision who to pay those fees to. That is why the ethical rules say you must have a client's consent before you pay your fees to somebody else. That is the rule in New York and there is nothing about the general partnership law or about Judge McMahon's decision that mandates a different result.

Thank you, your Honor.

THE COURT: Thank you, Mr. Feher.

Counsel, I want to thank you for your arguments today. They have been informative. I want to compliment all of you on your briefs. They are outstanding.

Decision reserved.

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